

**IN THE MATTER OF THE APPLICATION REGARDING CONVERSION
OF PREMIERA BLUE CROSS AND ITS AFFILIATES**

Washington State Insurance Commissioner's Docket # G02-45

REPORT OF

Banc of America Securities LLC

**Opinions as to Market Acceptance and
Issues Related to the Proposed Conversion of
Premiera Blue Cross**

November 10, 2003

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BLUE CROSS

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Introduction

Banc of America Securities LLC ("BAS") has been asked to serve as an expert witness in the proceeding addressing the proposed conversion of PREMERA, Premera Blue Cross, and certain of its affiliates (collectively, "Premera" or the "Company") from a non-profit to a for-profit health insurance company followed by an IPO. In connection with this role, BAS has been asked by Premera to address specific questions related to a potential conversion and IPO. These questions are the following:

- ◆ Is Premera's strategy of converting and accessing the public equity market reasonable?
- ◆ Will Premera be an attractive investment?
- ◆ Will Premera's proposed transaction structure and terms be acceptable to investors?
- ◆ What effect will Premera's issuance of new shares have on the Foundation Shareholder?

The first question is the most important, for if Premera's strategy of converting and accessing the public equity market is not reasonable, then analyzing the remaining questions becomes irrelevant.

If it is determined that Premera would benefit from raising equity capital, it would then be necessary to understand whether investors could view Premera as an attractive investment. The success of Premera's IPO is dependent upon the strength of the Company's IPO rationale and financial and operating metrics, including size, profitability, growth and margin. To determine Premera's investment appeal, its rationale and metrics can be compared with recent health insurance IPOs that have been successful.

Premera would also need to consider the effect of the proposed transaction structure and terms on its marketability and on the value of its shares. The key structure and terms include the voting rights and divestiture agreement regarding the Foundation Shareholder's ownership of Premera stock. The transaction structure and terms will need to satisfy the expectations of the investment community, or the value of Premera's shares and the Foundation Shareholder's stake will suffer.

Finally, if Premera chooses to issue primary shares in an IPO or secondary offering, it could increase or decrease the value of the Foundation Shareholder's stake. Therefore, the effects of a potential offering must be evaluated as well.



Banc of America Securities Qualifications

BAS has been asked to serve as an expert witness in Premera Blue Cross' proposed conversion to a for-profit company due to our broad market experience, including expertise within the health insurance industry, and more specifically, with BCBS companies. BAS is the investment banking arm of Bank of America Corporation, one of the world's largest universal banks. With corporate relationships extending to over 95% of the Fortune Domestic 500 and 78% of the Fortune Global 500, Bank of America is a leading global financial institution.

BAS encompasses full service investment banking capabilities with leading debt, equity and M&A products and services. BAS has been an underwriter in more than 90 IPOs since 2000.

BAS Healthcare Corporate & Investment Banking Group has more than 120 corporate and investment banking professionals dedicated to the healthcare industry. With nearly \$20 billion committed to healthcare clients, BAS Healthcare is recognized as a leader in the healthcare industry. Since 2000, BAS Healthcare has participated in over 20 healthcare IPOs and 3 health insurance IPOs. In addition, members of the BAS Healthcare team have participated in the following BCBS transactions and represent over 45 years of experience within the health insurance arena.

- ♦ 12 transactions for WellPoint Health Networks, including its conversion and IPO
- ♦ RightCHOICE sub-IPO from BCBS of Missouri
- ♦ Trigon conversion and IPO
- ♦ BCBS of Georgia conversion and sale to WellPoint Health Networks
- ♦ 8 transactions for Anthem, including its conversion and IPO, and its recent merger with WellPoint Health Networks
- ♦ BCBS of Connecticut's sale to Anthem
- ♦ BCBS of New Hampshire's acquisition of Matthew Thornton Health Plan
- ♦ Community Mutual BCBS' sale to Anthem
- ♦ United Wisconsin Group's \$70 million and \$45 million follow-on offerings

BAS' strong equity capabilities, combined with its expertise in the healthcare industry, and more specifically, experience with BCBS companies, make it well qualified to act as an expert witness on Premera's proposed conversion to a for-profit company.



Executive Summary

Is Premera's strategy of converting and accessing the public equity market reasonable?

Companies raise capital for two broad reasons: (i) to fulfill specific near-term needs and (ii) to provide strategic flexibility. Companies are better able to raise capital when they are in a strong financial position. Successful companies often raise capital before an actual specific need arises in order to achieve strategic flexibility. All health insurance companies undergoing IPOs over the last 13 years that raised capital for their own use did not have a specific stated purpose for most of that capital, other than to provide strategic flexibility.

Premera's strategy of converting and accessing the public equity market is advantageous for several reasons. First, Premera's risk-based capital ("RBC") level is not only well below the BCBS system-wide level, but is among one of the lowest. Second, Premera will lack sufficient cash reserves at its parent entity post-conversion and IPO unless it is allowed to issue primary shares in the offering. Cash at the parent level, which is maintained by all other public health insurance companies, provides financial flexibility to support growth initiatives, to invest in infrastructure and to weather downturns in company performance. Without access to the public markets and without financial flexibility, non-profit companies, such as Premera, have limited options when capital is needed most, including times of financial burden, or to support additional growth opportunities.

Completing an IPO is the most effective way in which Premera is likely to be able to raise additional material capital to increase strategic flexibility. Additionally, gaining access to the public equity market should enable Premera to facilitate future capital raises that may be necessary as the Company grows.

Conclusion → It is reasonable for Premera to take advantage of its current financial position to access the public equity market to increase its strategic flexibility and execute its strategic objectives.

Will Premera be an attractive investment?

Investors will invest in a company only if its qualitative and quantitative characteristics are compelling. If Premera undertakes an IPO, investors will analyze the strengths and weaknesses of its operations based upon what they view to be the important characteristics and core competencies of successful health insurance companies. In addition, investors will require that Premera have certain metrics, such as size, profitability, growth and margin, that are comparable to similar health insurance companies that have undergone this type of transaction.

Premera's IPO rationale is comparable to the rationales of other successful health insurance IPOs, and Premera's metrics fall within or near the range of nine recent health insurance companies that have undergone an IPO.

Conclusion → Premera's rationale and metrics should satisfy investor expectations, taking into account past trends and current market conditions, and therefore, be viewed as an attractive investment.



Will Premera's proposed transaction structure and terms be acceptable to investors?

It is common in BCBS conversions to have a significant owner (the Foundation Shareholder). Investors are well versed in this type of transaction and have been comfortable with such structures historically.

Investors will use comparable company transactional documents to evaluate a company's proposed transaction structure and terms. Therefore, it is important for Premera to have transaction structure and terms that are similar to recent BCBS conversions in order to limit the control of the Foundation Shareholder. If not, investors are likely to significantly undervalue Premera due to concerns regarding the Foundation Shareholder's ability to divest shares in an organized and rational manner, as well as concerns over corporate governance issues.

Conclusion → Premera's proposed transaction structure and terms are similar to the structure and terms of the three previous successful offerings, WellPoint, RightCHOICE and WellChoice and, on that basis, are likely to be acceptable to investors, taking into account past trends and current market conditions.

What effect will Premera's issuance of new shares have on the Foundation Shareholder?

Successful companies look to maximize long-term shareholder value, rather than short-term, and investors perceive value in companies that maintain strategic flexibility at the expense of short-term dilution.

In examining the use of proceeds of previous successful conversions, it is apparent that all of the health insurance companies that raised capital for their own use raised capital primarily for "general corporate purposes". Investors have come to accept this and view this as a strength for companies, as it enhances strategic flexibility and generates the possibility of long-term value creation. If companies invest proceeds efficiently in the long term, earnings accretion will be achieved.

The ultimate strategy of the Foundation Shareholder is to maximize value upon liquidation of shares, regardless of short-term ownership or earnings dilution. It is possible for more value to be created for the Foundation Shareholder, even if Premera sells primary shares in the IPO and the Foundation Shareholder sells secondary shares in a subsequent follow-on offering. In addition, the value to the Foundation Shareholder is directly correlated to the success of Premera. The Foundation Shareholder and Premera's interest are aligned in creating value for the Company. Premera's stock price will be indicative of its performance and will have a direct result on the value of the Foundation Shareholder's shares.

Conclusion → The impact to the Foundation Shareholder from Premera issuing primary shares is determined by the long-term use of proceeds. If Premera utilizes these proceeds in a strategic manner to support growth, then raising primary capital in an IPO may increase value for the Foundation Shareholder. Furthermore, it is possible for the Foundation Shareholder to realize greater cash proceeds by allowing Premera to issue primary shares in the IPO and waiting to sell secondary shares in a follow-on offering.



Question # 1

Is Premera's strategy of converting and accessing the public equity market reasonable?

As the first step in analyzing Premera's conversion and subsequent IPO, we must ask whether it is reasonable for Premera to access the public equity market in order to achieve strategic flexibility to enhance its competitive position.

To determine the reasonableness of Premera accessing the public equity market, BAS examined the general reasons that companies raise capital, Premera's specific need to raise capital, and the options Premera currently has to raise additional capital.

GENERAL REASONS FOR RAISING CAPITAL

In general, companies seek to raise capital for two broad reasons. The first is to provide them with funds for a specific near-term purpose. For example, a company may want to raise cash to make a specific pending acquisition or bolster its financial condition during a time of financial distress. Raising capital in this manner, however, creates several problems for companies. A company's ability to raise capital fluctuates constantly. This is true regardless of the type of capital being raised, as the bank, public debt and equity markets are all subject to "hot" and "cold" periods and fluctuate according to external factors such as the tightening or loosening of credit by the Federal Reserve, interest rates, movements in the stock market, mutual fund inflows and outflows, investor sentiment, the general state of the economy, etc. The fluctuations of the capital markets may or may not coincide with the timing of a company's specific need. If the openness of the market and a company's specific need for capital do not coincide, the company cannot take advantage of an immediate opportunity or rectify an identified problem. Furthermore, company-specific situations may create significant hindrances in either raising the capital or achieving the strategic objective behind the capital raise. For example, if a company is distressed, it may not be able to raise money or may be forced to do so at very unattractive terms. Similarly, if a company must make an acquisition contingent upon raising capital, it reduces the relative attractiveness of its acquisition proposal to the seller.

As a result, companies often raise capital for a second reason – to provide strategic flexibility. Strategic flexibility is essential for companies to prosper, as it provides a growth mechanism during times of financial stability and a reserve during times of financial distress. Successful companies often choose to access the capital markets to achieve strategic flexibility and raise money in advance of a specific need. This strategy is beneficial to companies, as they are able to achieve the best possible valuation and cheapest capital during times of financial strength. In addition, companies avoid the risk of being shut out of the market during times when the markets are weak, but a company's need for capital is great. To illustrate this point, BAS analyzed the IPOs of health insurance companies over the past 13 years. As every IPO in Table 1.1 demonstrates, a significant amount of the proceeds raised by the companies for their own use was not earmarked for a specific need, but rather for "general corporate purposes".



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(\$ in millions)

TABLE 1.1

Company	Ticker	At IPO		Net Proceeds to Company ^(a)	Use of Proceeds
		% Proceeds For Company	% Proceeds For Other		
Blues					
Anthem	ATH	23.1%	76.9%	\$429.8	\$1,434MM to pay those eligible statutory members of Anthem insurance in connection with demutualization \$79.5MM in underwriting discounts; \$32MM in offering and other expenses Remaining balance of \$429.8MM for general corporate purposes
RightCHOICE	RIT	100.0%	0.0%	34.7	General corporate purposes, including acquisitions
Trigon	TGH	31.6%	68.4%	68.1	\$56MM for a portion of the Commonwealth Payment \$91.3MM in cash payments to Eligible Members in the demutualization Remaining \$68.1MM for general corporate purposes, including acquisitions
WellPoint	WLP	100.0%	0.0%	514.4	General corporate purposes, primarily to further increase the Company's capital base to support future growth
WellChoice	WC	5.8%	94.2%	28.0	\$28MM from exercising of over-allotment used to pay offering and conversion expenses and for general corporate purposes
Non-Blues					
AMERIGROUP	AGP	98.5%	1.5%	77.9	\$13.3MM to redeem Series E mandatory redeemable preferred stock \$4.7MM to repay term loan facility \$54.8MM for general corporate purposes, including potential acquisitions
Centene	CNTE	80.5%	19.5%	41.5	\$4.0MM to repay principal amount of subordinated notes \$37.5MM for general corporate purposes, including working capital and potential acquisitions
Molina	MOH	100.0%	0.0%	120.8	Repayment of amounts under credit facility Purchase up to \$19.6MM in common stock from existing shareholders Remaining proceeds for general corporate purposes, including working capital and acquisitions
United Wisconsin ^(b)	UWZ	100.0%	0.0%	18.3	General corporate purposes including investing in subsidiaries to increase capital and support growth

Source: Company IPO prospectuses filed with the SEC.

(a) Includes exercise of over-allotment.

(b) United Wisconsin was the for-profit subsidiary of BCBS of Wisconsin. Because it did not have to undergo a conversion process to have an IPO, it is listed as a non-Blue.

PREMERA'S NEED TO RAISE CAPITAL

Like all of the companies in Table 1.1, Premera would use equity capital for general corporate purposes, such as increasing capital reserves, investing in infrastructure or developing new products. Without the infusion of additional capital, Premera lacks the strategic flexibility necessary to achieve its full growth potential, take advantage of future opportunities, and weather operating downturns:

Risk Based Capital

As a health insurance company, a significant rationale for Premera to achieve strategic flexibility is to maintain a capital level in excess of statutory requirements. At a current RBC level of 406%, Premera has a cushion over the requirements of insurance regulators. As a licensee of the Blue Cross Blue Shield Association (the "BCBS"), however, it is also subject to minimum RBC requirements of the BCBS and risks forfeiture of its license should it violate those requirements. It is essential for Premera to maintain its BCBS license (detailed in the Appendix of this document and page 26 of the Blackstone Group's report for the State of Washington Office of Insurance Commissioner (the "Blackstone report")); therefore, the Company must manage the amount of capital and surplus it maintains above BCBS requirements. The loss of the BCBS license would have a significant impact on the operations and marketability of the Company, including the loss of the BlueCard.

It is important for companies to maintain RBC levels above the BCBS "Early Warning Level" of 375%. As RBC levels fall below 375%, companies experience increased levels of monitoring and financial guarantees by the BCBS. Furthermore, it places companies closer to a level where BCBS license forfeiture could result (200% RBC). Thus, management may take a more conservative approach to running the business, and shift its focus to maintaining an RBC above 375%, instead of best serving its customers or increasing its strategic flexibility. Given



Premera's current RBC level of 406%, the amount of cushion is quite thin. [

PROPRIETARY MATERIAL REDACTED

] As Premera implements its plans for growth, the amount of capital required will grow as well. Without accessing the capital markets, it may be difficult for Premera to achieve its full growth potential. In addition, unforeseen opportunities or downturns may arise that can increase the need for capital.

Other BCBS licensees typically maintain capital and surplus levels well above Premera's. According to data from the BCBS, the system-wide RBC level of BCBS licensees in 2001 was 599%, versus Premera's 420%. In 2002, Premera's RBC level decreased to 406%, while the system-wide RBC level of BCBS licensees increased to 623%. Premera's levels placed it as the fourth lowest among reporting BCBS companies in 2001 and the third lowest in 2002.

Cash at Parent

Another important method of determining the strategic flexibility of a health insurance company is to analyze the amount of cash held at the parent holding company level. Other than a small amount required for working capital purposes, cash held at the parent exists specifically to provide strategic flexibility. In the event that reserves of one of its regulated subsidiaries decrease to certain threshold levels, or decline relative to the subsidiary's growth, the parent can use this cash to boost the subsidiary's reserves. Health insurance companies also use this cash to service and repay debt, make acquisitions, invest in infrastructure or develop new products. BAS analyzed the cash amounts held at the parent company level of health insurance companies that are currently publicly traded and included those amounts in Table 1.2 for all companies that reported such information in their SEC filings. As Table 1.2 demonstrates, most publicly traded health insurance companies have a significant amount of cash at the parent level.

(\$ in millions)

TABLE 1.2

	Cash at Parent
Anthem	\$685.1
Coventry Health Care	86.7
Health Net	207.1
Humana	187.0
Oxford Health	124.3
PacifiCare ^(a)	76.0
Sierra Health ^(b)	50.2
UnitedHealth Group	730.0
WellChoice	319.6
WellPoint Health Networks	85.7

Note: Data as of 6/30/03. Information not available for MME.

Source: Company SEC documents.

(a) Includes restricted cash collateral for FHP senior notes and restricted marketable securities.

(b) Excludes cash held by discontinued operations and cash designated for use only by regulated subsidiaries.



Premera currently maintains a nominal amount of cash at the parent level. Without cash at the parent, Premera will lack the strategic flexibility that other public health insurance companies have.

FORM OF CAPITAL RAISED

Companies are able to raise capital from a variety of sources, only one of which is a public equity offering. BAS looked at potential alternate sources of capital and determined the following:

- ♦ Premera can likely raise additional debt in order to meet some capital requirements. However, the Company could not raise as much capital through a debt offering as it could in an IPO, and the issuance of debt would not improve RBC reserves.
- ♦ Premera could potentially raise capital in a surplus notes offering. However, a typical surplus notes offering raises approximately \$75-\$100 million. The amount available to increase RBC is limited to 10-20% of current statutory capital. In addition, it would only have a one-time effect in boosting RBC reserves. Additionally, Premera may have difficulty in raising a surplus notes offering because of the investment grade requirement.
- ♦ Sale / leaseback of selected assets is not a significant additional source of capital for the Company.
- ♦ Premera could potentially examine the sale of certain assets as a source of capital. However, Premera determined that this was not a feasible option as (i) the ability to separate the business would be difficult, (ii) it would sacrifice future growth potential, and (iii) it would not generate a significant amount of proceeds.
- ♦ Merger with a larger national plan could be used as an additional source of capital. However, the Board of Directors has reviewed this particular option and believes that it is not consistent with the Company's objectives.

The means through which Premera can raise a material amount of capital, other than an issuance of public equity, are limited to methods whereby it would either (i) adversely impact its RBC ratio, or (ii) cede local control of the plan to an out of state insurer. As described above, any option that adversely impacts the RBC ratio would limit Premera's strategic flexibility and therefore, defeat the purpose of raising capital.

By raising capital through an IPO, Premera will also facilitate any future capital raises that may be required as Premera grows. For example, publicly traded companies are generally able to access the debt markets at more economical levels than non-publicly traded companies. In addition, should a financial dilemma strike Premera, unless it is a publicly traded company, it would have very limited means by which it could seek assistance. As a non-profit, non-stock company in financial turmoil, Premera would not be able to undergo an equity capital raise; its only alternative to resolve its financial dilemma would be to seek the help of a strategic acquirer. Several past examples of such a situation exist, including Anthem's acquisitions of BCBS of Colorado, Maine, and New Hampshire, and Health Care Service Corp's acquisition of BCBS of New Mexico. A summary of each of these deals is as follows:

- ♦ **BCBS of Colorado** – Anthem's acquisition of BCBS of Colorado came at a time when BCBS of Colorado was in desperate need of capital to fund operating expenses. Anthem's offer included a \$50 million loan that was needed immediately to fund operating activities.
- ♦ **BCBS of Maine** – In 1996, BCBS of Maine was valued at approximately \$500 million. Through the late 1990s, BCBS of Maine suffered from an extremely competitive market environment and was not able to take advantage of economies of scale or invest in



infrastructure. While the company survived the price wars, it was left in a position of financial turmoil and needed additional capital in order to operate its business competitively. It was also believed that BCBS of Maine could not successfully compete in the market without being part of a larger national company. As a result, the company was sold to Anthem in 1999 for approximately \$120 million.

- ♦ **BCBS of New Hampshire** – The New Hampshire market was extremely competitive and in the year prior to Anthem's acquisition of BCBS of New Hampshire, the company had a net loss of approximately \$20 million. The company had experienced a net loss over the past several years which resulted in extremely low capital levels. In order to remain competitive, additional capital or a strategic partner was required.
- ♦ **BCBS of New Mexico** – BCBS of New Mexico was highly leveraged with a low capital base. It did not have the size to compete in the market and did not have the capital to invest in infrastructure. As a result, its only viable option was to seek a strategic partner. Health Care Service Corp. purchased BCBS of New Mexico in 2001 for \$55 million.

On the contrary, after the public companies Coventry, Oxford and PacifiCare ran into financial trouble, they were able to raise additional capital from outside investors in March 1997, February 1998 and May 2002, respectively. Although this capital was expensive due to the financial distress of the companies, each company was able to maintain its independence, resolve its problems, and realize a better value for shareholders, rather than sell the entire company to a strategic buyer at depressed levels. Since the time of the capital raise, Coventry's stock has risen 578%, Oxford's 221% and PacifiCare's 116%.

CONCLUSIONS

In general, successful companies raise capital before the actual need arises in order to achieve strategic flexibility. All health insurance companies undergoing IPOs over the last 13 years that raised capital for their own use did not have a specific stated purpose for most of the capital, other than to provide strategic flexibility. Waiting to raise capital until a specific need arises, such as a potential acquisition or solution to a financial crisis, can force a company to raise capital at a high cost or to forego a strategic opportunity. In the case of financial distress, it may be impossible to raise capital at all, and non-publicly traded companies may have no choice but to sacrifice their independence.

Premera, like the other health insurance companies undergoing health insurance IPOs, intends to use the capital for general corporate purposes such as increasing capital reserves, investing in infrastructure or developing new products. Its RBC levels are among the lowest of the BCBS licensees and, [

PROPRIETARY MATERIAL REDACTED

] In addition, Premera has nominal cash at the parent level. As a result, Premera lacks the strategic flexibility required to achieve its full growth potential or to protect it in an operating downturn.

In order to achieve such strategic flexibility, it is reasonable for Premera to access the capital markets. Completing an IPO is the most effective way in which Premera is likely to be able to raise additional material capital without either adversely impacting its RBC or, if deemed appropriate by the Board, exploring a strategic partnership.



Question # 2

Will Premera be an attractive investment?

In question #1, BAS concluded that it would be reasonable for Premera to access the capital markets through the completion of an IPO, due to the strategic flexibility that the proceeds of an offering would provide. The fact that an IPO is reasonable for Premera, however, does not mean it is attractive to public investors. If Premera does not satisfy the expectations of investors in public companies, it may not be able to complete a successful IPO, as investors might prefer to invest their capital elsewhere. The next logical step is to determine whether Premera would be an attractive investment, taking into account past trends and the current state of facts and market conditions.

Not every company is a suitable candidate for an IPO. Investors expect that a company undergoing an IPO have certain metrics, such as size, profitability, growth and favorable margins. Furthermore, investors prefer a company whose investment rationale is compelling.

There have been nine health insurance IPOs completed in the last 13 years. Table 2.1 lists these IPOs and their stock price performances post-IPO. The fact that these IPOs were completed and had significant stock price increases indicates they were deemed attractive in the eyes of investors. As a result, BAS compared Premera to these previous IPOs on both a

(\$ in millions)

TABLE 2.1

Company	Date of IPO	Size of Offering	Price Change				S&P 500 Price Change			
			IPO + 1 Month	IPO + 3 Month	IPO + 6 Month	IPO + 1 Year	IPO + 1 Month	IPO + 3 Month	IPO + 6 Month	IPO + 1 Year
Molina Healthcare, Inc.	07/02/2003	\$123.5	33.6%	52.6%	37.4% ^(a)	37.4% ^(a)	(1.4%)	2.7%	6.5% ^(a)	6.5% ^(a)
WellChoice, Inc.	11/08/2002	480.0	1.6%	(22.0%)	(1.9%)	31.1% ^(a)	2.0%	(7.3%)	2.9%	18.3% ^(a)
Centene Corporation	12/13/2001	56.4	51.5%	48.2%	95.0%	133.4%	2.3%	3.1%	(9.8%)	(19.5%)
AMERIGROUP Corporation	11/06/2001	86.0	20.1%	25.0%	38.8%	79.5%	4.3%	(3.2%)	(5.9%)	(17.4%)
Anthem, Inc.	10/29/2001	1,987.2	38.9%	47.8%	85.1%	82.2%	5.7%	2.1%	(1.2%)	(18.2%)
Trigon Healthcare, Inc.	01/31/1997	231.7	37.5%	42.3%	80.8%	90.9%	0.6%	1.6%	20.5%	24.7%
RightCHOICE	08/02/1994	41.1	3.4%	26.1%	28.4%	18.2%	2.3%	1.3%	2.7%	21.3%
WellPoint Health Networks, Inc.	01/28/1993	231.7	0.9%	8.9%	12.5%	13.8%	1.2%	(0.0%)	2.3%	8.9%
United Wisconsin Services	10/24/1991	20.0	5.1%	51.7%	46.5%	308.5%	(2.3%)	7.9%	6.2%	7.5%

qualitative and quantitative basis.

Source: FactSet and company filings.

Note: Size of offering includes exercise of over-allotment. All stock prices adjusted for stock splits.

(a) Represents price change from IPO to current date (11/06/03).

QUALITATIVE CHARACTERISTICS

If Premera undertakes an IPO, investors are likely to analyze the strengths and weaknesses of its operations based upon what they view to be the important characteristics and core competencies of successful health insurance companies. Specifically, investors are likely to want to ensure that Premera provides high quality healthcare insurance products and services, builds and maintains strong provider networks, makes sound underwriting decisions, is in good standing with regulatory authorities, has effective product design and, most importantly, possesses a highly satisfied customer base that believes Premera adds significant value.

As part of the process of marketing its IPO to investors, a company must develop an IPO rationale that highlights the company's strengths and explains why investors should find it attractive. IPO rationales can vary widely, even among companies within the same industry. For example, three of the last five health insurance IPOs have been Medicaid-only focused companies. These companies have no commercial membership and thus did not market their IPO rationales in a way that is similar to how a predominantly commercial plan would approach the investment community. With respect to Premera, its IPO rationale would be most similar to



that of the other two recent health insurance IPOs – WellChoice and Anthem – which also happen to be the most recent BCBS companies to complete IPOs. In Table 2.2, BAS compares the strengths that would be marketed in a Premera IPO story with the strengths that were marketed in the WellChoice and Anthem IPOs.

TABLE 2.2

WellChoice	Anthem	Premera
<ul style="list-style-type: none"> Strong regional market share Well-recognized brand name Broad provider network Breadth of products and services 	<ul style="list-style-type: none"> Strong market share Well-recognized brand name Broad provider network Breadth of products and services 5th largest publicly-traded health insurance company Vast geographic reach Acquisition track record 	<ul style="list-style-type: none"> Regional leadership in Washington and Alaska Blue Cross Blue Shield franchise strength Broad provider network Broad array of proven next generation products and systems Strong momentum in operating and financial performance Growth opportunities Experienced management team with a successful track record

Source: Wall Street research for WellChoice and Anthem; Company presentation and discussion with management for Premera.

As demonstrated above, Premera's IPO rationale shares many of the key selling points of both Anthem and WellChoice, although it lacks the size and geographic reach of Anthem, as well as its successful acquisition history. While this places Premera in a different category than Anthem, WellChoice was also a regionally-focused, mid-sized health insurance plan with no acquisition history and was able to successfully complete an IPO. Furthermore, there have been companies whose rationales have lacked these components but were highly recognized by the investment community. Perhaps the best example of this is Mid-Atlantic Medical ("MAMSI"), a publicly traded health insurance company that operates in one region (mid-Atlantic), possesses significant size (2.0MM members), and has never made an acquisition. Despite this, MAMSI's stock has appreciated significantly more than the large health insurance companies over the past 3 years, and its price to earnings ("P/E") multiple has consistently been higher.

CHART 2.1 – INDEXED STOCK PRICE PERFORMANCE

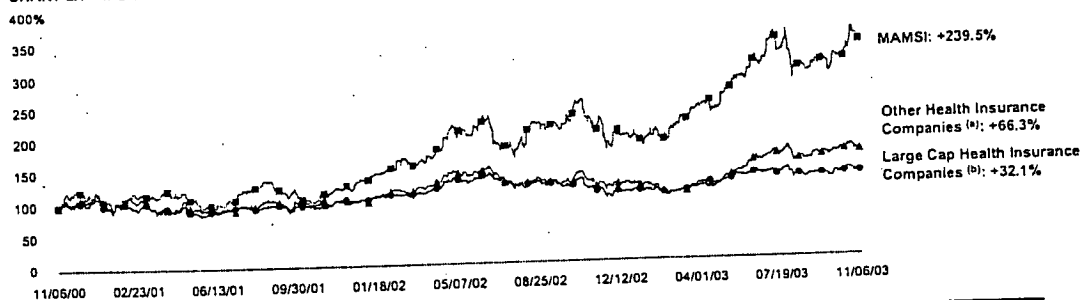
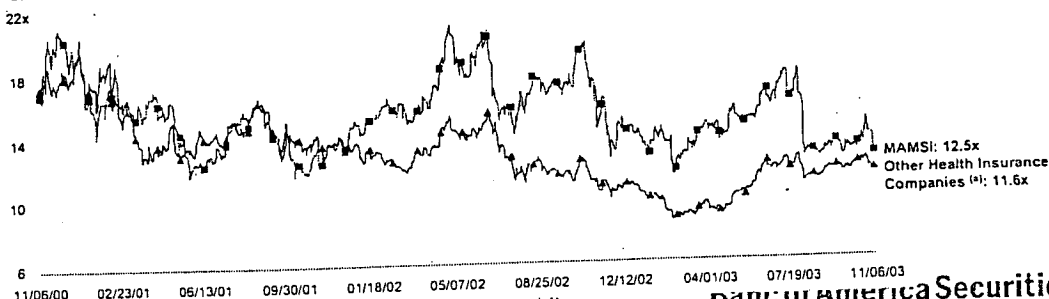


CHART 2.2 – NEXT TWELVE MONTHS P/E



Source: Factset.
(a) Other MCOs include CNG, CVH, FHCC, HNT, HUM, OHP, PHS, SIE and WC.
(b) Large Cap MCOs include AET, ATH, CI, UNH and WLP.



QUANTITATIVE METRICS

In addition to understanding and evaluating Premera's story, investors will also analyze Premera's financial metrics. For the reasons described below, the investment community primarily focuses on the metrics of size, profitability, growth and margin. Investors focus on these metrics, both historically and prospectively.

Size dictates whether a company has attained enough critical mass to effectively compete in the market place. With health insurance companies, size is often measured by membership. In order to achieve scale through membership increases, a company must provide superior products and value to its customers. Size is also necessary to realize significant operating synergies and economies of scale, which in turn drive increases in other key metrics, such as profitability and margin.

Generating a profit is essential as it is the means by which investors realize a return on their capital. Profitability is also a key factor in maintaining financial strength. A track record of historical profitability is especially important in health insurance companies, as it demonstrates a company's ability to successfully estimate and plan for healthcare costs.

Growth indicates value creation for shareholders. Historical growth is important because it validates management's track record and ability to successfully run and grow the company. Future growth is important because it is a direct driver of future value. Specifically, the primary focus of the investment community is on earnings per share growth (net income divided by diluted shares outstanding) as a proxy for company performance. Therefore, Premera's net income growth will be of particular importance to the investment community.

Margin is an indication of operational efficiency. Although, margin can vary significantly between health insurance companies due to different business and product mix and different geographic locations. Investors tend to place greater value on businesses that have higher operating efficiencies than their competitors. However, some low margin companies can still be valued highly. If investors are convinced of the upside potential for margin improvement, a lower margin company can warrant a greater valuation than a higher margin company.

BAS compared Premera's historical and projected financial metrics to those health insurance companies listed in Table 2.1. By analyzing each company's historical financials prior to its IPO, and projected financials for the first two years following its IPO, a range can be determined. If Premera has performed, and is projected to perform, within or near the range of metrics of prior successful health insurance companies, it should be well received by the investment community.



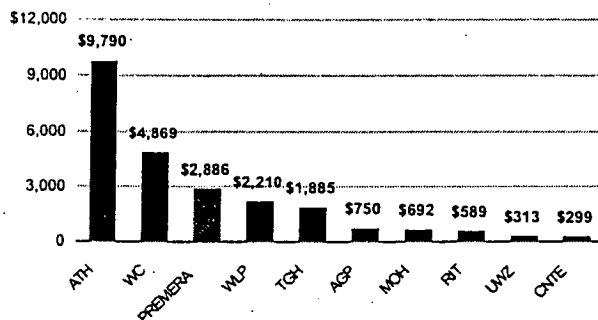
Size and profitability

Size and profitability are important metrics that the investment community analyzes in determining how successful / adequate a company new to the public equity market will be. Size dictates whether a company has attained enough critical mass to effectively compete in the market place. With health insurance companies, size is often measured by membership. In order to achieve scale through membership increases, a company must provide superior products and value to its customers. Size is also necessary to realize significant operating synergies and economies of scale, which in turn drive increases in other key metrics, such as profitability and margin. The size and profitability of health insurance companies at the time of their entrance into the public equity market fall into a wide range. This wide range is expected, as these companies are materially different from one another with regard to national versus regional plans, product offering and mix, and time of public market entrance.

Although Premera's size and profitability are less than those of some health insurance companies that have undergone IPOs, Premera is significantly larger and more profitable than other successful health insurance IPOs. The tables below demonstrate that Premera's size and profitability are squarely within the range of comparable companies that have successfully completed IPOs and were positively received by the market.

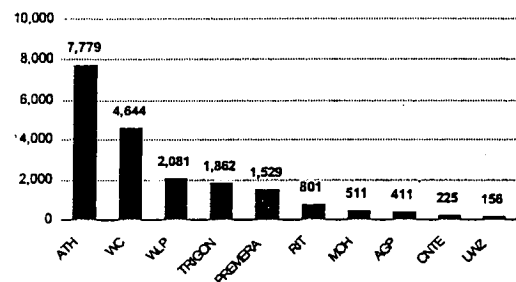
(\$ in millions)

LTM REVENUE ^{(a) (b)}



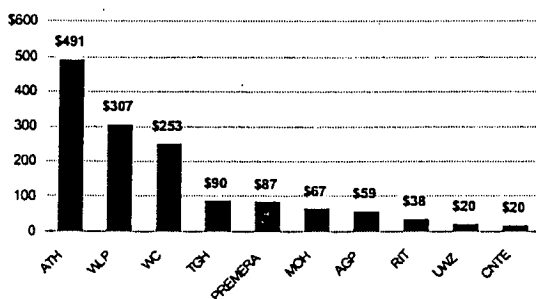
(Membership in thousands)

LTM MEDICAL MEMBERSHIP ^(c)



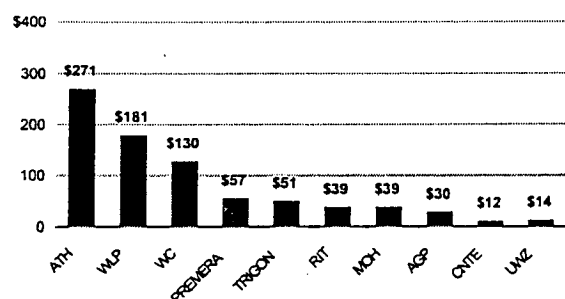
(\$ in millions)

LTM EBITDA ^{(a) (b)}



(\$ in millions)

LTM NET INCOME ^(b)



Note: LTM (latest twelve month) data for period prior to initial public offering. Premera LTM as of 12/31/03 using updated 3-year model.
Source of Premera data: Premera management.

Source of comparable company data: Wall Street research and company filings with the SEC.

(a) Includes investment income.

(b) Excludes non-recurring items and realized gains/(losses) on investments. Premera net income adjustments tax-affected at a 22% tax rate.

(c) Membership includes fully insured and administrative services contracts.



In comparing profitability, BAS examined the financials of Premera as a whole. This is the primary focus of investors. While an analysis of product lines may provide useful information, no public health insurance companies disclose financial information with that level of detail. For this reason, a factually correct comparative analysis by product line is difficult to achieve and thus not relied upon by investors.

Growth

Growth is also an important metric analyzed by investors. In fact, because growth is often a direct indication of value creation for shareholders, it is often the most important metric for investors. Historical growth is important because it validates management's track record and ability to continue to successfully grow and run the company. Future growth is important because it provides a proxy for expected performance and value creation. Growth of other health insurance companies at the time of their entrance into the public equity market falls into a wide range. This wide range is expected, as these companies are materially different with regards to national versus regional plans, product offering and mix, completed acquisitions, and time of public market entrance. For Premera to be well received by investors, we would expect to see growth fall within or near the range of comparable companies.

Although Premera's recent historical growth is below that shown by some health insurance companies at the time of their IPOs, its overall growth rate is comparable, especially over the longer term.

Company	MEMBERSHIP GROWTH		
	Historical ^(a)	Projected	
		IPO + 1 ^(b)	IPO + 2 ^(b)
Anthem, Inc.	11.2%	11.6%	5.4%
Centene Corporation	36.5%	NA	NA
RightCHOICE	11.7%	NA	NA
Trigon Healthcare, Inc.	3.5%	NA	NA
United Wisconsin Services, Inc.	3.4%	NA	NA
WellChoice, Inc.	6.0%	5.3%	1.9%
WellPoint Health Networks, Inc.	8.4%	11.6%	4.2%
AMERIGROUP Corporation	24.2%	37.3%	12.0%
Molina Healthcare, Inc.	20.9%	7.9%	3.6%
Hi	36.5%	37.3%	12.0%
Low	3.4%	5.3%	1.9%
Median	11.2%	11.6%	4.2%
Premera (Form A)	9.2%		
Premera (Most Recent 3-Yr Plan)	5.7%		

Company	REVENUE GROWTH		
	Historical ^(a)	Projected	
		IPO + 1 ^(b)	IPO + 2 ^(b)
Anthem, Inc.	40.3%	18.1%	11.6%
Centene Corporation	9.9%	48.3%	21.7%
RightCHOICE	5.2%	NA	NA
Trigon Healthcare, Inc.	11.3%	7.5%	9.8%
United Wisconsin Services, Inc.	39.1%	NA	NA
WellChoice, Inc.	10.1%	9.5%	7.1%
WellPoint Health Networks, Inc.	12.4%	18.4%	8.5%
AMERIGROUP Corporation	65.4%	33.8%	21.7%
Molina Healthcare, Inc.	27.8%	21.6%	8.2%
Hi	65.4%	48.3%	21.7%
Low	5.2%	7.5%	7.1%
Median	12.4%	18.4%	9.8%
Premera (Form A)	13.5%		
Premera (Most Recent 3-Yr Plan)	9.0%		

PROPRIETARY MATERIAL REDACTED

Company	EBITDA GROWTH		
	Historical ^(a)	Projected	
		IPO + 1 ^(b)	IPO + 2 ^(b)
Anthem, Inc.	69.7%	18.3%	17.6%
Centene Corporation	NM	141.7%	51.9%
RightCHOICE	6.0%	NA	NA
Trigon Healthcare, Inc.	10.4%	11.2%	17.4%
United Wisconsin Services, Inc.	117.7%	NA	NA
WellChoice, Inc.	66.7%	66.7%	12.0%
WellPoint Health Networks, Inc.	116.8%	27.6%	5.8%
AMERIGROUP Corporation	337.3%	34.4%	26.9%
Molina Healthcare, Inc.	16.9%	13.7%	11.9%
Hi	337.3%	141.7%	51.9%
Low	6.0%	11.2%	5.8%
Median	68.2%	27.6%	17.4%
Premera (Form A)	12.3%		
Premera (Most Recent 3-Yr Plan)	10.7%		

Company	NET INCOME GROWTH		
	Historical ^(a)	Projected	
		IPO + 1 ^(b)	IPO + 2 ^(b)
Anthem, Inc.	66.2%	52.5%	16.8%
Centene Corporation	NM	88.6%	39.1%
RightCHOICE	4.2%	NA	NA
Trigon Healthcare, Inc.	10.1%	11.5%	18.5%
United Wisconsin Services, Inc.	66.0%	NA	NA
WellChoice, Inc.	63.6%	76.0%	11.2%
WellPoint Health Networks, Inc.	119.3%	24.5%	5.0%
AMERIGROUP Corporation	131.0%	29.1%	24.6%
Molina Healthcare, Inc.	19.8%	12.2%	12.8%
Hi	131.0%	88.6%	39.1%
Low	4.2%	11.5%	5.0%
Median	64.8%	29.1%	16.8%
Premera (Form A)	10.2%		
Premera (Most Recent 3-Yr Plan)	11.1%		

Note: Revenue and EBITDA include investment income. All figures exclude non-recurring items and gains / losses in investment. Premera net income adjustments tax-affected at a 22.5%. Form A data as of 3/21/03. Most recent 3-year plan as of October 2003.

Source: Wall Street research and company documents.

(a) Data reflects year / year growth for fiscal year prior to IPO date. Premera historical data for FY ending 12/31/03.

(b) Data reflects year / year growth for next fiscal year (IPO + 1) and 2nd fiscal year (IPO + 2) after IPO.

PROPRIETARY MATERIAL REDACTED



Although membership and revenue growth provide important insights into a company's performance and future, revenue growth without profitability growth is not viewed all that favorably. It is for this reason, therefore, that net income growth is the primary focus of the investment community. Furthermore, projected net income growth is more important than historical, as future growth is what will create value. As a public company, Premera's EPS (earning per share, or net income divided by diluted shares outstanding) and EPS growth will be a key determinant of investor confidence in the company, which will directly relate to its success. It is important to note, therefore, that while all of Premera's growth metrics fall within the range of prior health insurance IPO companies, its projected net income in year two post-IPO approximates the median of all comparable companies.

Margin

Margin is an important metric analyzed by investors as it provides an indication of operational efficiency. Investors tend to place greater value on businesses that have higher operating efficiencies than their competitors. Although this is generally the trend, some companies with high margins may trade at lower P/Es as investors question the sustainability of these higher margins. This is apparent when comparing the margins and P/E of Oxford Health Plans to the broader health insurance industry. Oxford Health Plans' LTM EBITDA margin is 11.1%, the highest of all health insurance companies ^(a), but its 2003 P/E is 9.8x, one of the lowest among all health insurance companies. Conversely, a company with low margins may trade at a higher P/E as investors see upside potential in margin improvement. WellChoice's low margins were a selling point in its IPO.

Margins of health insurance companies at the time of their entrance into the public equity market fall into a wide range. This wide range is expected, as these companies are materially different with regards to national versus regional plans, product offering and mix, and time of public market entrance. For Premera to be well received by investors, we would expect to see its margins fall within or near the range of comparable companies.

Value is created if a company can improve margins. However, this does not imply that health insurance companies can simply raise premiums to increase their margins. On the contrary, raising premiums will likely lead to customer attrition, resulting in a decrease in growth and profitability. Margin improvement can also result from other means, such as operational efficiencies. Premera's margins fall toward the low end of the range, indicating the Company has significant margin expansion opportunities.

Premera's historical and projected medical loss ratio and SG&A margins are within the range of comparable health insurance companies and are likely to satisfy investor expectations. Although Premera's EBITDA and net income margins are below the range of comparable companies, we believe that these margins are likely to be acceptable to the investment community and viewed as an attractive investment. The Company has a five-year track record of improving its margins and expects continued improvement over the next few years.

(a) Health insurance universe comprised of AET, AGP, AMZ, ATH, CI, CNC, CVH, HNT, HUM, MME, MOH, OHP, PHS, SIE, UNH, WC and WLP.



Company	MEDICAL LOSS RATIO				
	Historical			Projected	
	IPO - 2	IPO - 1	LTM	IPO + 1	IPO + 2
Anthem, Inc.	84.6%	84.7%	84.5%	85.1%	85.0%
Centene Corporation	88.9%	84.3%	83.0%	83.4%	82.8%
RightCHOICE	77.4%	75.8%	74.7%	NA	NA
Trigon Healthcare, Inc.	74.1%	80.9%	80.7%	80.2%	80.0%
United Wisconsin Services, Inc.	84.3%	83.0%	82.7%	NA	NA
WellChoice, Inc.	88.4%	88.1%	87.5%	88.1%	85.8%
WellPoint Health Networks, Inc.	76.4%	72.9%	72.5%	72.3%	72.1%
AMERIGROUP Corporation	85.2%	81.0%	80.7%	81.0%	81.0%
Molina Healthcare, Inc.	81.8%	82.6%	82.7%	83.2%	82.7%
HI	88.9%	88.1%	87.5%	88.1%	85.8%
Low	74.1%	72.9%	72.5%	72.3%	72.1%
Median	84.3%	82.6%	82.7%	83.2%	82.7%
Premiera (Form A)	84.5%	84.1%	84.2%		
Premiera (Most Recent 3-Yr Plan)	84.5%	84.1%	84.0%		

Company	SG&A MARGIN				
	Historical			Projected	
	IPO - 2	IPO - 1	LTM	IPO + 1	IPO + 2
Anthem, Inc.	15.8%	19.8%	19.4%	18.8%	19.9%
Centene Corporation	14.1%	14.0%	11.8%	10.9%	9.9%
RightCHOICE	20.3%	22.8%	23.8%	NA	NA
Trigon Healthcare, Inc.	20.0%	19.8%	19.1%	18.2%	18.0%
United Wisconsin Services, Inc.	13.0%	13.9%	13.8%	NA	NA
WellChoice, Inc.	16.0%	15.4%	15.1%	15.7%	15.9%
WellPoint Health Networks, Inc.	19.1%	17.7%	16.9%	17.9%	17.4%
AMERIGROUP Corporation	13.2%	12.9%	12.9%	12.3%	11.8%
Molina Healthcare, Inc.	8.5%	8.1%	7.9%	8.1%	8.2%
HI	20.3%	22.8%	23.8%	18.8%	19.9%
Low	8.5%	8.1%	7.9%	8.1%	8.2%
Median	15.8%	15.4%	15.1%	15.7%	15.9%
Premiera (Form A)	15.7%	15.6%	16.1%		
Premiera (Most Recent 3-Yr Plan)	15.7%	15.6%	16.1%		

Company	EBITDA MARGIN				
	Historical			Projected	
	IPO - 2	IPO - 1	LTM	IPO + 1	IPO + 2
Anthem, Inc.	3.1%	5.3%	5.0%	5.3%	6.2%
Centene Corporation	NM	4.2%	6.7%	6.8%	8.5%
RightCHOICE	6.5%	6.5%	6.4%	NA	NA
Trigon Healthcare, Inc.	10.0%	4.8%	4.8%	4.9%	5.3%
United Wisconsin Services, Inc.	3.9%	8.0%	8.5%	NA	NA
WellChoice, Inc.	2.7%	4.1%	5.2%	6.2%	6.5%
WellPoint Health Networks, Inc.	8.2%	11.9%	13.9%	12.9%	12.6%
AMERIGROUP Corporation	2.9%	7.7%	7.9%	7.8%	8.1%
Molina Healthcare, Inc.	10.4%	9.5%	9.6%	8.9%	9.2%
HI	10.4%	11.9%	13.9%	12.9%	12.6%
Low	2.7%	4.1%	4.8%	4.9%	5.3%
Median	5.0%	6.0%	6.5%	6.8%	8.1%
Premiera (Form A)	2.7%	3.0%	2.9%		
Premiera (Most Recent 3-Yr Plan)	2.7%	3.0%	3.0%		

Company	NET INCOME MARGIN				
	Historical			Projected	
	IPO - 2	IPO - 1	LTM	IPO + 1	IPO + 2
Anthem, Inc.	1.4%	2.3%	2.6%	3.0%	3.5%
Centene Corporation	NM	3.2%	3.9%	4.1%	4.7%
RightCHOICE	4.0%	3.9%	6.7%	NA	NA
Trigon Healthcare, Inc.	6.0%	2.7%	2.7%	2.8%	3.0%
United Wisconsin Services, Inc.	2.5%	3.0%	4.4%	NA	NA
WellChoice, Inc.	1.4%	2.0%	2.7%	3.3%	3.4%
WellPoint Health Networks, Inc.	3.7%	7.3%	8.2%	7.7%	7.4%
AMERIGROUP Corporation	2.8%	4.0%	4.0%	3.8%	3.9%
Molina Healthcare, Inc.	6.0%	5.6%	5.6%	5.2%	5.4%
HI	6.0%	7.3%	8.2%	7.7%	7.4%
Low	1.4%	2.0%	2.7%	2.8%	3.0%
Median	3.3%	3.2%	4.0%	3.8%	3.9%
Premiera (Form A)	1.8%	1.9%	1.9%		
Premiera (Most Recent 3-Yr Plan)	1.8%	1.9%	2.0%		

Note: SG&A excludes depreciation and amortization. Revenue and EBITDA include investment income. All figures exclude non-recurring items and gains / (losses) on investments. Premiera net income adjustments tax-affected at a 22% tax rate. Form A data as of 3/21/03. Most recent 3-year plan as of October 2003.

Source: Wall Street research and company documents.

CONCLUSIONS

Investors will invest in a company only if its rationale is compelling. In addition, investors will examine whether a company undergoing an IPO has acceptable metrics, such as size, profitability, growth and margin. Premiera's IPO rationale is comparable to other successful health insurance IPOs, and its metrics fall within or near the range of nine recent health insurance IPO transactions. Therefore, based on these comparisons, Premiera's rationale and metrics are likely to satisfy investor expectations, taking into account past trends and current market conditions, and are likely to be viewed as an attractive investment.



Question # 3

Will Premera's proposed transaction structure and terms be accepted by investors?

For Premera to complete a successful IPO, the investment community must be comfortable with Premera's proposed transaction structure and terms. The conversion process and IPO will result in a publicly traded Premera with the Foundation Shareholder owning a majority of the outstanding shares. This is an area of concern for investors, as one owner could (without proper structure and terms) have significant influence and voting power in the company.

As Table 3.1 demonstrates, it is quite common for a company's ownership post-IPO to be dominated by one or more significant investors, which often maintain majority control.

TABLE 3.1 Company	% of Company Offered in IPO	Major Shareholder Ownership Pro Forma for IPO	
AMERIGROUP	23.0%	C. Sage Givens (Acacia Venture Partners)	13.8%
		Carlos Ferrer (Ferrer Freeman)	12.9%
		Charles W. Newhall, III (NEA Ventures)	10.9%
Anthem	53.3%	None - Demutualization	
Centene	32.3%	Greylock Limited Partnership	21.1%
		Strategic Investment Partners	19.8%
Molina	25.4%	Molina Family	70.0%
RightCHOICE	20.0%	Missouri Foundation for Health	80.0%
Trigon	38.8%	None - Demutualization	
United Wisconsin	16.7%	United Wisconsin for Health Foundation	83.3%
WellChoice	7.5%	New York Public Asset Fund	79.0%
WellPoint Health Networks	19.6%	California HealthCare Foundation	80.4%

Source: Company SEC filings.

What investors rely upon, however, is that these controlling shareholders are rational investors who will exert their influence to drive long-term shareholder value.

The Foundation Shareholder's goal, investment strategy and interest may not be aligned with public shareholders. For example, the Foundation Shareholder may be required to monetize in response to certain objectives and may divest a significant portion of its holdings at any given time. This may cause unnecessary selling pressure on the stock, driving share price down. Similarly, a Foundation Shareholder given complete voting control could elect a Board of Directors that is thought to serve its interests, but not be ideally suited to run a public company.

COMPARISON OF STRUCTURE AND TERMS

For these reasons, investors seek a transaction structure and terms that provide a predetermined framework for the exercise of the voting rights of the stock held by the Foundation Shareholder. It is important that this framework be consistent with the strategic direction of the company, as set by the Board, and support the orderly divestiture of the company's common stock in order to increase public float and transfer ownership outside of the



Foundation Shareholder. For Premera to be accepted by the investment community, investors must be confident that the proper structure and terms are in place. If they are not, investors may decide not to invest in Premera stock or do so only at a reduced value.

As an aside, it was suggested by the State's consultants that a provision be created to help maximize the funds flowing to the charitable organization from the Foundation Shareholder. This would require Premera to "top up" the Foundation Shareholder's proceeds from the IPO should Premera's share price rise above a certain percentage several trading days after the IPO. The "top up" would require Premera to pay the difference between the average closing share price of Premera stock on the exchange where it is listed and the IPO price. BAS believes this provision is unwarranted in a conversion process as it was designed for demutualizations where there are many small, unsophisticated shareholders. In a demutualization process, existing shareholders often choose to liquidate their entire ownership position, whereas the Foundation Shareholder typically sells only a relatively small portion of its holdings during the IPO. In addition, most investors expect a company's stock price to increase in the weeks following the IPO. As a result, if there is a "top up" provision, new public investors will decrease the value they place on shares at the time of investment based upon what they believe the "top up" would be. Should the price not rise as quickly as investors expect, the Foundation Shareholder would be likely to lose value because of the "top up" provision. Furthermore, any top up payment would decrease the value of the Foundation Shareholder's shares it still holds at the time of payment.

Investors will look to previous successful conversions and simultaneous IPOs to compare Premera's transaction structure and terms. In order to ensure the success of the conversion, Premera will need to show that its structure and terms are comparable to, and not necessarily identical with, similar successful historical transactions.

BAS has analyzed the structure and terms of the three most comparable BCBS conversion transactions from a non-profit to a for-profit company through an IPO. As seen in Question #2, all of these IPOs were successful in the receptivity of investors to the IPO transaction. This implies that the structure and terms for all three companies were also accepted by the investment community. From the perspective of public investors, the most important areas of the transactional documents associated with BCBS conversions and IPOs are those that deal with corporate governance, ownership and voting.



TABLE 3.2

WellChoice (NY)	WellPoint (CA)	RightCHOICE (MO)	Premera
Limitations on Common Stock Ownership Max 10% of voting securities for an institutional owner Max 5% of voting securities for a non-institutional owner Max 20% total ownership for any person BCBS waived the ownership limitations for the Fund	Limitations on Common Stock Ownership Max 10% of voting securities for an institutional owner Max 5% of voting securities for a non-institutional owner Max 20% total ownership for any person BCBS waived the ownership limitations for the Fund	Limitations on Common Stock Ownership Max 10% of voting securities for an institutional owner Max 5% of voting securities for a non-institutional owner Max 20% total ownership for any person BCBS waived the ownership limitations for the Fund	Limitations on Common Stock Ownership Max 10% of voting securities for an institutional owner Max 5% of voting securities for a non-institutional owner Max 20% total ownership for any person BCBS waived the ownership limitations for the Fund
Divestiture Agreement Fund is required to reduce its holdings to less than 50% of the outstanding capital stock within 3 years of the conversion Less than 20% within 5 years Less than 5% within 10 years	Divestiture Agreement Foundation required to reduce holdings outside the voting trust to less than 50% within 3 years of the conversion To less than 20% within 5 years Transfers 80% of stock sale proceeds to the Endowment	Divestiture Agreement Foundation required to reduce holding to less than 80% after within 1 year of the conversion To less than 50% within 3 years To less than 20% within 5 years Have 1 to 2 year extensions, respectively	Divestiture Agreement Foundation required to reduce holding to less than 80% after 1 year of IPO To less than 50% within 3 years To less than 5% after 6 years Have 1 year and 3 year extensions
Voting Trust Agreement Fund's shares deposited into a voting trust Trustee of trust must vote with independent BOD except on employee compensation plans and change of control matters	Voting Trust Agreement Foundation required to enter into a voting trust agreement Required to vote all shares owned in excess of 5% in favor of BOD nominees	Voting Trust Agreement Foundation required to enter into a voting trust agreement Required to vote with independent BOD majority	Voting Trust Agreement Foundation required to enter into a voting trust agreement Required to vote with independent BOD majority
Demand Registration Rights Commencing 180 days from the date of the offering, and all of the time until all stock is sold Fund will have the right to demand registration of its shares and has the right to join the demand	Demand Registration Rights Any and all of the time until stock is sold	Demand Registration Rights Any and all of the time until all stock is sold	Demand Registration Rights Commencing immediately after the IPO, and all of the time until all stock is sold

Source: Company Form A documents.

Table 3.2 demonstrates that Premera's major structure and terms, as filed in its Form A, are similar to WellChoice, WellPoint and RightCHOICE. There are no differences in limitations of common stock ownership between the four companies. The divestiture agreements vary slightly and the most significant difference is the requirement that Premera's Foundation Shareholder reduce its holdings to less than 5% after 6 years. WellChoice requires its Foundation Shareholder to reduce its holdings to less than 5% within 10 years and RightCHOICE and WellPoint to below 20% within 5 years. In addition, Premera has a one-year requirement to reduce shares below 80%, whereas WellPoint and WellChoice do not. The voting trust agreements of all companies are relatively similar. Premera's demand registration rights are similar to RightCHOICE and WellPoint, but differs from WellChoice's in that WellChoice has a 180-day restriction from the date of the offering.



In summary, Premera's proposed transaction structure and terms are similar to those of WellPoint, RightCHOICE and WellChoice, and therefore are likely to be acceptable to the investment community.

DISTRIBUTION OF FOUNDATION SHAREHOLDER'S SHARES

In addition to the actual structure and terms, the manner in which large shareholder positions are ultimately distributed to the public is important to investors. Large shareholders will decrease their position over time. Investors know this and want this distribution to occur in an orderly fashion. If the Foundation Shareholder liquidates its shares back into the market in an unorganized manner and floods the market with an excess amount of shares, it can place significant pressure on the stock, leading to a decrease in price. Investors have become comfortable with the BCBS conversion process, particularly as it relates to the liquidation of the large shareholders' positions. For example, the distribution of Foundation Shareholder shares in the case of WellPoint was very successful and well received by investors, as demonstrated by Chart 3.1 on the following page.

Through past conversion experience, investors now anticipate that any large Foundation Shareholder of a new BCBS company undergoing an IPO will distribute its shares in a similar, economically rational manner.

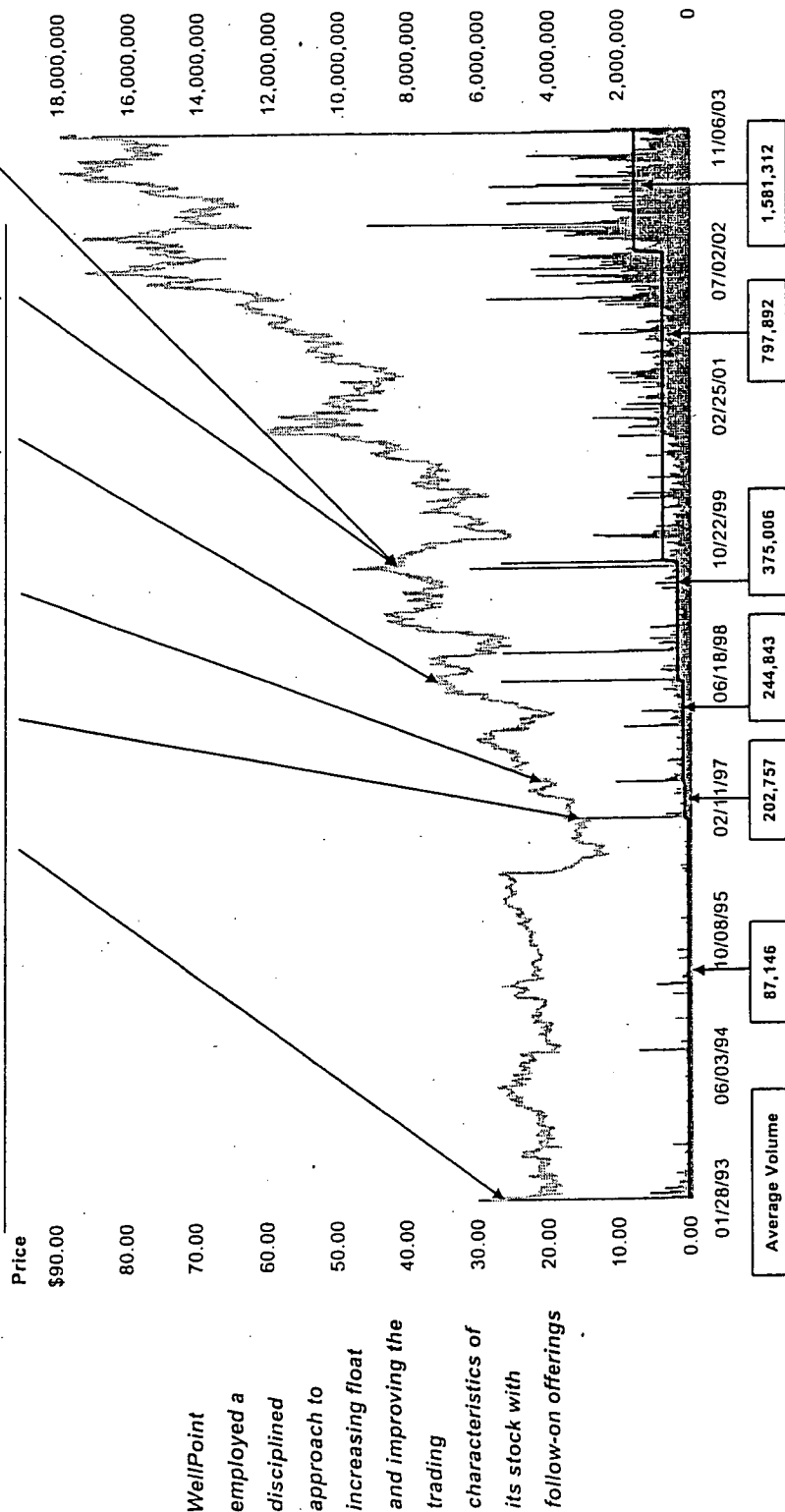


WellPoint's regulated monetization of the Foundation Shareholder's stake was well-received by investors

CHART 3.1

Date:	1/28/93 ^(a)	11/21/96	4/7/97	4/15/98	6/29/99
Secondary Shares Offered:	0	13 million	10 million	12 million	10 million
Price: ^(b)	\$14.00	\$14.00	\$19.00	\$36.00	\$40.50
% Public Float:	17.5%	39.3%	54.8%	74.4%	88.3%
% Foundation Ownership	72.5%	60.7%	45.2%	25.6%	11.7%
Monetization of Foundation Stake:	--	\$364MM	\$266MM	\$864MM	\$728MM
Total Monetization	--	\$364MM	\$630MM	\$1,494MM	\$2,222MM

July 1999
WLP repurchased 2MM
shares from Foundation.
Generated approximately
\$170MM for the
Foundation.



(a) Initial public offering.
(b) Adjusted for 2-1 stock split.

In order to minimize stock price pressure during the Foundation Shareholder's liquidation and distribution of shares, it is important for the distribution to be managed in an organized fashion.

For this purpose, we examined the trading multiples of two relatively recent managed care IPOs – AMERIGROUP (NYSE: AGP) and Centene (NYSE: CNC). Centene's distribution of shares was well received by the market, while AMERIGROUP's was not.

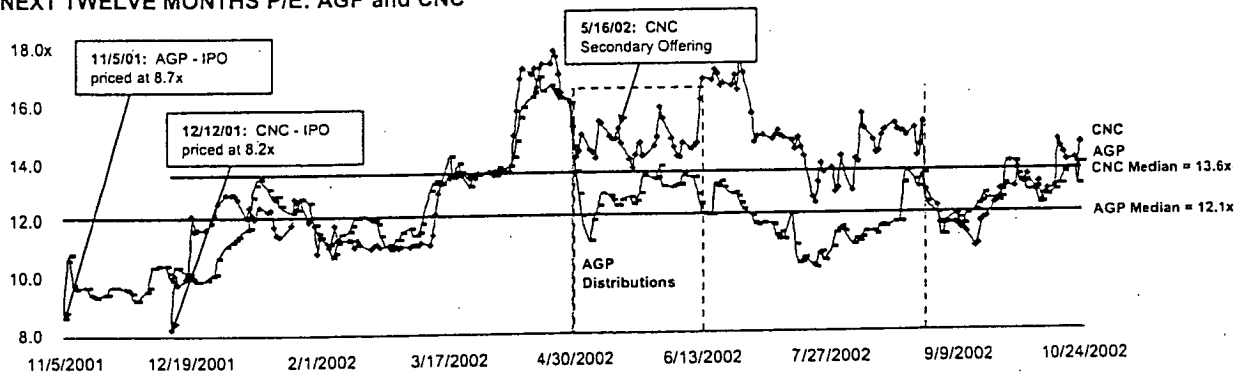
AMERIGROUP and Centene both completed IPOs in late 2001 and traded in sync with each other for approximately 6 months. Both AMERIGROUP and Centene are Medicaid focused insurance companies and hence, direct comparables of each other. Both AMERIGROUP's and Centene's pre-IPO owners (separate groups of investors) held stock after the IPO.

In May 2002, Centene underwent an orderly distribution of its pre-IPO owners' stock through a secondary offering of 5.75MM shares^(a). In contrast, AMERIGROUP's pre-IPO owners decided to reduce their ownership position through a direct distribution of the shares to their limited partners, rather than through an organized public offering. The limited partners, in turn, liquidated their positions by selling in the open market in an uncoordinated fashion, placing significant pressure on the stock.

Chart 3.2 displays the valuation disparity that occurred in the near-term as a result.

CHART 3.2

NEXT TWELVE MONTHS P/E: AGP and CNC



Source: FactSet.

Although the two companies eventually traded in-line once again, Centene carried a definite multiple advantage over AMERIGROUP for approximately 4 months.

AMERIGROUP's stock did not recover until after the distributions were completed (i.e., after the investors had sold their stock at lower multiples).

CONCLUSIONS

It is common in BCBS conversions to have a significant owner (the Foundation Shareholder). Investors are well versed in this type of transaction and have been comfortable with such structures historically.

It is important for Premera to have the proper structure and terms in order to limit the control of the Foundation Shareholder, as other BCBS conversions had. If not, investors will significantly undervalue the Company due to concerns regarding the Foundation Shareholder's ability to divest shares in an organized and rational manner, as well as concerns over corporate governance issues.

(a) Includes the exercise of over-allotment of shares.



Premiera's current structure and terms are similar to the three previous successful offerings mentioned in Table 3.2 and, on that basis, are likely to be acceptable to investors under certain market conditions.



Question # 4

What effect will Premera's issuance of new shares have on the Foundation Shareholder?

If Premera pursues an IPO, it is effectively selling a portion of the Company to the public. The ultimate goal of the Foundation Shareholder will be to liquidate all of its shares and generate the largest amount of proceeds possible. The value the Foundation Shareholder ultimately receives will, in a large part, depend upon the earnings of Premera.

The amount of earnings accretion / dilution experienced by the Foundation Shareholder will depend upon two primary factors: the size of the return that the proceeds from the offering generate and the valuation at which the shares are sold. If the proceeds generate low or negative returns, the Foundation Shareholder may experience earnings dilution. If the proceeds generate high returns, the Foundation Shareholder may experience earnings accretion. Similarly, the higher a company's valuation, the more likely an offering of shares will be accretive.

Furthermore, it is more important to analyze the long-term effects rather than the short-term effects. Successful companies look to maximize long-term shareholder value rather than short-term value. Investors ascribe value to companies that maintain strategic flexibility even at the expense of short-term dilution. In order to maintain strategic flexibility, a company may access the public equity market without necessarily stating a specific use of proceeds, as discussed in question #1.

Looking at the long-term effects of the proposed offering is also essential when examining the IPOs effect on a company's return on equity ("ROE"). The near-term effect of any equity offering will typically lower a company's ROE as the denominator, average shareholders' equity, increases, while the numerator, net income, sees only limited benefits from the offering until the proceeds begin to generate a higher return. The use of proceeds and the expected rate of return will determine, in the long-term, the effects of an equity offering on ROE.



USE OF PROCEEDS

In response to question #1, BAS concluded that it would be reasonable for Premera to access the public equity market through the completion of an IPO due to the strategic flexibility this would provide. BAS analyzed the last nine health insurance IPOs and summarized the use of proceeds in Table 4.1 below. Most of these health insurance IPOs involved raising capital for both company use and distribution of cash to pre-IPO shareholders. In each instance, the bulk of proceeds raised by the companies for their own use was not earmarked for a specific purpose, but rather for "general corporate purposes". The proceeds would therefore be invested in cash and marketable securities in the short term, thereby generating a low return and having a probable dilutive impact.

Unless one assumes that all of the companies in Table 4.1 were owned by irrational investors prior to the IPO, in each case investors, at the time of IPO, decided to accept limited short-term returns and probable short-term dilution in exchange for strategic flexibility and the possibility of

(\$ in millions)

TABLE 4.1

Company	Ticker	At IPO		Net Proceeds to Company ^(a)	Use of Proceeds
		% Proceeds For Company	% Proceeds For Other		
Blues Anthem	ATH	23.1%	76.9%	\$429.8	\$1,434MM to pay those eligible statutory members of Anthem insurance in connection with demutualization \$79.5MM in underwriting discounts; \$32MM in offering and other expenses Remaining balance of \$429.8MM for general corporate purposes
RightCHOICE	RIT	100.0%	0.0%	34.7	General corporate purposes, including acquisitions
Trigon	TGH	31.6%	68.4%	68.1	\$56MM for a portion of the Commonwealth Payment \$91.3MM in cash payments to Eligible Members in the demutualization Remaining \$68.1MM for general corporate purposes, including acquisitions
WellPoint	WLP	100.0%	0.0%	514.4	General corporate purposes, primarily to further increase the Company's capital base to support future growth
WellChoice	WC	5.8%	94.2%	28.0	\$28MM from exercising of over-allotment used to pay offering and conversion expenses and for general corporate purposes
Non-Blues AMERIGROUP	AGP	98.5%	1.5%	77.9	\$13.3MM to redeem Series E mandatory redeemable preferred stock \$4.7MM to repay term loan facility \$54.8MM for general corporate purposes, including potential acquisitions
Centene	CNTE	80.5%	19.5%	41.5	\$4.0MM to repay principal amount of subordinated notes \$37.5MM for general corporate purposes, including working capital and potential acquisitions
Molina	MOH	100.0%	0.0%	120.8	Repayment of amounts under credit facility Purchase up to \$19.6MM in common stock from existing shareholders Remaining proceeds for general corporate purposes, including working capital and acquisitions
United Wisconsin ^(b)	UWZ	100.0%	0.0%	18.3	General corporate purposes including investing in subsidiaries to increase capital and support growth

Source: Company IPO prospectuses filed with the SEC.

(a) Includes exercise of over-allotment.

(b) United Wisconsin was the for-profit subsidiary of BCBS of Wisconsin. Because it did not have to undergo a conversion process to have an IPO, it is listed as a non-Blue.
long-term value creation.

ACCRETION / (DILUTION) TO FOUNDATION SHAREHOLDERS

In determining whether or not the issuance of primary shares is accretive or dilutive to the Foundation Shareholder, it is of primary importance to calculate how the cash proceeds are ultimately used by the company. For example, if the company uses the cash for an acquisition, the rate of return may be much higher than if it keeps the cash in marketable securities, and will therefore result in accretion. Similarly, if the company, as in the case of Premera, uses the cash



to build reserves that will be necessary for the company to grow, the rate of return may also be high and result in accretion, as the company could not grow as quickly without it.

Table 4.2 illustrates the accretion and dilution of a \$100 million offering, assuming various rates of return, as well as a wide range of valuation multiples. As this table demonstrates, the issuance of primary shares can be accretive if suitable long-term (greater than 1-year) rates of return are achieved. In addition, a company's P/E also impacts the accretive nature of an IPO. It should be noted that companies who maintain strategic flexibility typically trade at higher valuation multiples (P/E) than those that are constrained in their options. A company with strategic flexibility is typically better capitalized and possesses a better risk profile, which collectively may lead to a higher valuation multiple.

TABLE 4.2

Rate of Return on Proceeds	
Multiple at Which Premera May Trade	<div> <div>6.0x</div> <div>8.0x</div> <div>10.0x</div> <div>12.0x</div> <div>14.0x</div> <div>16.0x</div> <div>18.0x</div> <div>20.0x</div> </div> <div>PROPRIETARY MATERIAL REDACTED</div>
Note: Assumes \$100 million IPO offering of primary shares and [] IPO discount. Based on 2004P net income of [] Assumes tax rate of [] PROPRIETARY MATERIAL REDACTED	

SALE OF FOUNDATION SHAREHOLDER'S SECONDARY SHARES DURING IPO VERSUS FOLLOW-ON OFFERING

While it is useful to analyze the accretive / dilutive effects to the Foundation Shareholder in terms of earnings, it is of greater importance to compare the cash proceeds received by the Foundation Shareholder upon selling its shares. The ultimate strategy of the Foundation Shareholder is to maximize value upon the liquidation of shares regardless of ownership or earnings dilution. To illustrate this point, BAS performed an analysis that compares two scenarios, one in which the Foundation Shareholder sells shares in an IPO (Scenario A) and one in which the Foundation Shareholder sells an equivalent number of shares in a follow-on offering within the first year of the IPO that consisted entirely of primary shares (Scenario B).

SCENARIO A \$100 MM INITIAL PUBLIC OFFERING		SCENARIO B \$100 MM FOLLOW-ON OFFERING	
2004 Net Income ^(a)		2005 Base Net Income ^(a)	
Additional Net Income From Investment in IPO Proceeds		Additional Net Income From Investment of IPO Proceeds ^(b)	
2004 Pro Forma Net Income		2005 Pro Forma Net Income	
Multiple ^(c)		Multiple ^(c)	
Equity Value (Pre-IPO Discount)		Equity Value	
IPO Discount			
Equity Value (Post-IPO Discount)			
# of Shares Outstanding ^(a)	PROPRIETARY MATERIAL REDACTED	# of Shares Outstanding	PROPRIETARY MATERIAL REDACTED
Implied Offer Price		Implied Offer Price	
Size of Offering		Size of Offering	
# of Shares Offered		# of Shares Offered	
Discount Rate		Discount Rate	
Present Value of Gross Proceeds		Present Value of Gross Proceeds	
Less: Gross Spread for IPO of 7.0%		Less: Gross Spread for Follow-On of 5.25%	
TOTAL DOLLARS RAISED BY FUND		TOTAL DOLLARS RAISED BY FUND	
(a) Per Premera management. Adjusted for non-recurring items.		PROPRIETARY MATERIAL REDACTED	
(c) Represents mean 2004 P/E multiple of BCBS companies, as illustrated in the Blackstone report.			

As demonstrated above, the Foundation Shareholder will realize greater value by waiting to sell its shares in a follow-on offering rather than selling at the IPO, even assuming that the IPO



proceeds are invested in a way that is EPS dilutive (i.e., at a 4% rate of return). It is important to note the above analysis assumes constant multiples. Premera may trade at a higher valuation multiple (P/E) in a scenario in which its primary shares are issued, as the market would view Premera as better able to take advantage of strategic opportunities and to weather any potential problems.

REVIEW OF AMERIGROUP FOLLOW-ON OFFERING

In order to illustrate a transaction where the existing shareholders experienced EPS dilution, yet the transaction was well received by the market, we analyzed the AMERIGROUP follow-on offering. As there is no public stock price change in an IPO, BAS chose to analyze a follow-on offering because we are able to track stock price change associated with the transaction.

On October 9, 2003, AMERIGROUP completed a \$128 million follow-on offering of 2.75 million primary shares. While the transaction was approximately 9% dilutive, it was highly successful, pricing at a 0.6% discount to levels at the time. The stock was up 3.6% from file to offer, and increased 6.8% during marketing. At pricing, AMERIGROUP's stock had appreciated 175% since its IPO. Use of proceeds for the transaction was not specific, but was to be used for working capital, general corporate purposes and acquisitions. The transaction was 4.75x oversubscribed and the \$19 million over-allotment was exercised within one week of pricing.

CONCLUSIONS

Successful companies generally look to maximize long-term shareholder value, and investors perceive value in companies that maintain strategic flexibility at the expense of short-term dilution.

In examining the use of proceeds of previous successful conversions, all of the health insurance companies that raised capital for their own use raised capital primarily for "general corporate purposes." Investors have come to accept this and view this as a strength for companies, as it enhances strategic flexibility and generates the possibility of long-term value creation. As Table 4.2 demonstrated, if companies invest proceeds efficiently, earnings accretion is likely to be achieved.

Finally, the analysis of the value created through the Foundation Shareholder's liquidation of shares, either at the IPO or a subsequent follow-on offering, proves that more value can be created for the Foundation Shareholder if Premera sells primary shares in the IPO and the Foundation Shareholder sells secondary shares in a subsequent follow-on offering, even in light of an EPS dilutive transaction. In addition, the value to the Foundation Shareholder is directly correlated to the success of Premera. The Foundation Shareholder and Premera's interests are aligned in creating value for the Company. Premera's stock price will be indicative of its performance and will have a direct impact on the value of the Foundation Shareholder's shares.

It is important to note that without a conversion and IPO, the Foundation Shareholder will not exist and therefore will not have any monetary value. Short-term dilution through the issuance of new shares is necessary to drive long-term shareholder value and create strategic flexibility. Premera is not likely to be able to increase its strategic flexibility and build long-term value without pursuing the proposed conversion and subsequent IPO.



Appendix

Value of BCBS Mark

Wall Street analysts look favorably upon the mark and would view its loss as a detriment to a BCBS company's value.

"If Premera were to lose the BCBS mark, its valuation would likely be meaningfully impacted. The loss of the BCBS mark would result in (i) a one-time payment by Premera of approximately \$22.8 million, (ii) the entry of a new competitor who would possess the BCBS mark, and (iii) the likely loss of members due to increased market competition in Washington and Alaska."

– *The Blackstone Group, October 2003*

"Our analysis indicates that for WellPoint Health Networks, the value of the brand accounts for over 50% of the total firm value. Roughly 42% of RightCHOICE's firm value is attributable to the value of the Blue Cross brand, while brand accounts for 32% of Trigon's total value."

– *Wall Street Analyst, December 2002*

"Blue Cross Blue Shield is the most recognized brand in health insurance today.....Relative to its major competitors, the Blues have higher brand awareness ratings and more positive brand image."

– *Wall Street Analyst, December 2002*

"Over the years, the "Blues" have earned a reputation for delivering high-quality health care, excellent customer service and competitive pricing. As a Blue Cross Blue Shield entity, Trigon benefits from the "Blues" strong brand recognition and reputation as a high-quality, dependable provider. Clearly, this furnishes a key differentiating advantage versus its competition."

– *Wall Street Analyst, February 1997*

